

FEDERAL ELECTION COMMISSION
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 SECRETARIAT

2006 NOV 22 P 2:24

FIRST GENERAL COUNSEL'S REPORT

SENSITIVE

MUR: 5736
 DATE COMPLAINT FILED: May 1, 2006
 DATE OF NOTIFICATION: May 9, 2006
 LAST RESPONSE RECEIVED: October 19, 2006
 DATE ACTIVATED: Sept. 12, 2006

EXPIRATION OF SOL: March 16, 2011

COMPLAINANTS: Washington State Democratic Central Committee

RESPONDENTS: Friends for Mike McGavick and Robert A. Ratliffe,
 in his official capacity as Treasurer
 Michael McGavick
 Safeco Corporation

RELEVANT STATUTES: 2 U.S.C. § 439a
 2 U.S.C. § 441b
 11 C.F.R. § 113.1(g)(6)

INTERNAL REPORTS CHECKED: Commission Indices

FEDERAL AGENCIES CHECKED: N/A

I. INTRODUCTION

This matter concerns allegations that Friends for Mike McGavick and Robert A. Ratliffe, in his official capacity as Treasurer ("Committee"), Michael McGavick, and Safeco Corporation ("Safeco") violated the Federal Election Campaign Act of 1971, as amended ("the Act"). The complaint alleges that payments from Safeco to Mike McGavick, who is the former CEO of Safeco and was the Republican candidate for U.S. Senator from Washington in the 2006 general election, constituted prohibited corporate contributions to his campaign, in violation of 2 U.S.C.

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1 § 441b. The complaint also alleges that McGavick violated 2 U.S.C. § 439a by converting the
2 contributions to personal use.

3 The complaint arises from the Executive Transition Services Agreement ("ETSA"), an
4 agreement that McGavick entered into with Safeco after McGavick announced his candidacy on
5 October 26, 2005. At the time that McGavick announced his candidacy, McGavick was the CEO
6 of Safeco. In light of his plans to depart Safeco and run for the U.S. Senate, McGavick and
7 Safeco agreed to alter the terms of his employment agreement, dated January 1, 2005, and enter
8 into the ETSA. However, responses and information obtained through publicly available sources
9 indicate that the payments were made irrespective of McGavick's candidacy. Thus, based on
10 available information discussed below, this Office recommends that the Commission find no
11 reason to believe that respondents violated 2 U.S.C. §§ 441b and 439a.

12 **II. FACTUAL BACKGROUND**

13 Michael McGavick was the Republican candidate for U.S. Senator from Washington for
14 the 2006 election. Safeco is a publicly traded insurance company based in Seattle, Washington.
15 Prior to his candidacy, McGavick was the Chairman, President, and Chief Executive Officer
16 ("CEO") of Safeco from 2001 through 2005. On October 26, 2005, McGavick announced his
17 plans to run for the U.S. Senate.

18 Shortly after McGavick announced his candidacy, McGavick resigned from Safeco, and
19 the parties entered into the ETSA on December 6, 2005, *see* Attachment A, which altered the
20 terms of his employment agreement dated January 1, 2005. The complaint alleges that the ETSA
21 changed the terms of McGavick's compensation after he became a candidate and allowed an
22 "accelerated" vesting of McGavick's unvested options to purchase 210,298 shares of Safeco

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1 stock worth \$4.5 million, and asks that the Commission investigate whether these changes
2 resulted in prohibited corporate contributions and personal use.

3 The complaint further contends that by allowing McGavick to remain on Safeco's payroll
4 through February 28, 2006, McGavick retained rights to \$9.8 million in options that he otherwise
5 would have had to forfeit and to \$2.9 million in restricted stock awards.¹ McGavick's extended
6 employment with Safeco also enabled him to become eligible for a lump-sum distribution from
7 the Safeco Employees' Cash Balance Plan, which fully vests after five years of service.² As
8 McGavick's service with Safeco began in January 2001, remaining on Safeco's payroll past
9 January 2006 permitted him to obtain benefits of the Cash Balance Plan. Finally, the complaint
10 claims that Safeco chose to award McGavick a bonus of \$2,314,180 for 2005 and asks the
11 Commission to investigate whether McGavick received this bonus "irrespective of his
12 candidacy" as provided in 11 C.F.R. § 113.1(g)(6).

13 While Respondents acknowledge that the terms of McGavick's employment were altered
14 under the ETSA, they argue that the payments resulting from the ETSA were made
15 "irrespective" of McGavick's candidacy under the three criteria set out in 11 C.F.R.
16 § 113.1(g)(6)(iii) and, therefore, do not constitute contributions. Respondents state that under
17 the ETSA, Safeco promised to accelerate and fully vest a certain group of McGavick's unvested

¹ On August 1, 2006, a Safeco shareholder sued Mr. McGavick, Safeco, and the Board of Directors alleging that the two-month employment in 2006 was an "'artifice' meant to help McGavick exercise more stock options." See Curt Woodward, *Shareholder Sues McGavick over Safeco Pay*, Associated Press, Aug. 2, 2006 at 1. Defendants in that suit recently filed a motion to dismiss stating that in exchange for the additional compensation granted in the ETSA, Mr. McGavick agreed to: 1) remain in office until a successor was named; 2) extend the non-compete clause in his contract from one to three years; and 3) provide transition services as requested by Safeco from January 1, 2006 through February 28, 2006. See Motion to Dismiss, *Schwartzman v McGavick et al*, CV06-1080 (MJP) (W.D. Wash. (Aug. 1, 2006)). Defendants did not elaborate on the services provided, stating only "McGavick performed significant services for Safeco during the period of time covered by the ETSA." *Id.*, at n.6.

² The complaint does not provide a dollar amount for the distribution that McGavick would have received from the Cash Balance Plan nor do publicly available company documents

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1 stock options in consideration of McGavick: 1) remaining as Safeco's President and CEO until
2 December 31, 2005; 2) providing transition services through February 28, 2006; and 3) not
3 competing with Safeco or soliciting its employees for three years following termination of his
4 employment.³ Company documents indicate that the 210,298 shares of Safeco common stock
5 that were accelerated for McGavick were worth approximately \$3.3 million,⁴ not \$4.5 million as
6 the complaint alleges. The respondents and company documents also claim that McGavick
7 suffered a loss because he had to forfeit \$7 million of stock options that had not vested by his
8 departure date.⁵ Safeco reduced McGavick's base salary from \$1.150 million to \$750,000
9 effective December 1, 2005 and further reduced his salary to \$100,000 per year effective January
10 1, 2006, when McGavick's successor would begin her term.⁶

11 In addition, Respondents contend that McGavick's bonus of \$2,314,180 (paid in 2006 for
12 his performance in 2005) was in the same range of his bonuses from prior years. According to
13 the Committee's Response, Safeco awarded McGavick performance-based bonuses for previous
14 years as follows:⁷

Year	Salary	Bonus
2001	\$790,972	\$2,039,235
2002	\$950,000	\$1,805,000
2003	\$1,000,000	\$1,850,000
2004	\$1,000,000	\$2,000,000

15
16 The ETSA provided that McGavick would be eligible to receive a 2005 bonus based on: 1) the
17 smooth and orderly transition of CEO responsibilities; 2) McGavick's commitment to remain

³ See Attachment A at 3, *see also* Attachment B, Safeco 2006 Proxy Statement at 30.

⁴ Attachment B at 30.

⁵ Committee Response at 3; Safeco Response at 3, note 1; Attachment B at 42.

⁶ Attachment A at 3.

⁷ See Committee Response at 3.

1 employed and to provide transitional support to Safeco through February 28, 2006; and 3)
2 Safeco's financial and operating performance for 2005.⁸

3 Respondents also claim that the terms of the ETSA were similar to the terms of a
4 severance package provided to another executive, Christine Mead, Chief Financial Officer
5 ("CFO") and President of Service, Technology and Finance, who departed from Safeco in
6 December 2005; therefore, they state Safeco's business practice of offering executive severance
7 packages demonstrates that the ETSA did not result in contributions. For example, Mead's
8 agreement, which was entered into approximately four months before the ETSA, provided for an
9 acceleration of a substantial number of option shares, which were valued at approximately \$4
10 million.⁹ Mead also was eligible for a 2005 bonus based upon: 1) a smooth and orderly
11 transition of her responsibilities; 2) her remaining employed with Safeco until December 31,
12 2005; 3) her performance of her duties; and 4) Safeco's 2005 results.¹⁰ Mead further agreed to a
13 two-year period of noncompetition with Safeco.¹¹ The terms of Mead's severance package,
14 however, did not include transition services, and Mead apparently left the company prior to her
15 successor joining Safeco.¹²

16 Additional research of publicly available information indicates that McGavick reported
17 pre-tax income of \$28 million from Safeco in 2006 even though he resigned in February the
18 same year. *See Alex Fryer, McGavick is Sitting on \$28 million from Safeco*, Seattle Times, June
19 17, 2006. The article notes that some of the income was derived from work he performed

⁸ Attachment A at 3; Attachment B at 30.

⁹ Attachment B at 42.

¹⁰ *Id*

¹¹ *Id*

¹² Mead's successor, Ross Kari, was named Safeco's new CFO effective June 21, 2006.

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several years ago, as well as \$11 million from stock options that Safeco requires its executives to exercise three months after resigning. *Id.*

III. LEGAL ANALYSIS

The complaint's central claim is that the alteration of the terms of McGavick's employment with Safeco, as set out in the ETSA, negotiated after McGavick announced his candidacy, resulted in prohibited corporate contributions and the conversion of campaign funds to personal use.¹³ Respondents, however, argue that the payments resulting from the ETSA were made "irrespective" of McGavick's candidacy under the three criteria set out in 11 C.F.R. § 113.1(g)(6)(iii) and, therefore, do not constitute contributions.

The Federal Election Campaign Act of 1971, as amended ("the Act"), prohibits corporations from making expenditures and contributions in connection with federal elections. 2 U.S.C. § 441b(a); 11 C.F.R. § 114.2(b)(1). The term "contribution" includes "any gift, subscription, loan, advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office." 2 U.S.C. § 431(8)(A).

The Act also prohibits the conversion of campaign funds to personal use. 2 U.S.C. § 439a(b)(2). A third party's payment of a candidate's expenses that would otherwise be deemed

¹³ The complaint could also be read to dispute the ability of a candidate to pursue gainful employment at the same time he or she runs for office, citing the fact that McGavick remained on Safeco's payroll despite his representation to the press that he was a "full-time candidate," *see* complaint at 2 (citing Matthew Daly, *Cantwell Retains Big Lead in Race for Senate Cash*, Associated Press, Feb. 2, 2006). As respondents point out, however, the Commission has permitted individuals to pursue employment while they are running for federal office. *See, e.g.*, AO 1977-45 and 2006-13. Remaining on a company's payroll in and of itself is not improper so long as the employment-related compensation was made "irrespective of the candidacy," including, among other things, that the individual does the work he or she is compensated for. *See* AO 2006-13 (citing 11 C.F.R. § 113.1(g)(6)(iii)). Furthermore, it does not appear that McGavick's representations to the press were untruthful as the full quote in the article cited by the complaint stated, "The bottom line is until the end of the year I was still CEO of Safeco and very much a part-time candidate," McGavick said. Now, he added, "I can be a full-time candidate, and that's a wonderful change, so we're feeling very good about the campaign." Daly, *supra*, at 1. Based on the public information that is available, as of February 2, 2006, McGavick indeed was no longer the CEO of Safeco. His statement that he "can be a full-time candidate" does not appear untruthful in that his responsibilities at Safeco were substantially reduced and would ultimately end by February 28, 2006.

1 “personal use” is considered a contribution by the third party unless the payment was made
2 “irrespective of the candidacy.” 11 C.F. R. § 113.1(g)(6); *see also* AO 2004-8 (American Sugar
3 Cane League). In the context of employment-related compensation, 11 C.F.R. § 113.1(g)(6)(iii)
4 provides that “[p]ayments that are compensation shall be considered contributions unless –

5 (A) The compensation results from *bona fide* employment that is genuinely
6 independent of the candidacy;

7 (B) The compensation is exclusively in consideration of services provided by the
8 employee as part of this employment; and

9 (C) The compensation does not exceed the amount of compensation which would
10 be paid to any other similarly qualified person for the same work over the same
11 period of time.” *Id.* (emphasis in original).

12 In AO 2004-8 (American Sugar Cane League), the Commission applied § 113.1(g)(6)(iii)
13 to determine whether a severance agreement of a departing executive, who resigned his position
14 that he long-served in order to run for federal office, constituted a prohibited corporate
15 contribution. When applying the first two criteria of the rule, the Commission observed that the
16 corporation had a past business practice of granting severance packages to other executives and
17 employees and that the corporation used objective factors such as job performance, position, and
18 length of service in determining whether to grant a severance package. The Commission thus
19 concluded that the executive’s package was exclusively tied to services rendered in his *bona fide*
20 employment with the corporation and satisfied § 113.1(g)(6)(iii)(A) and (B). In addition,
21 because the departing executive’s compensation appeared to be proportionate to past severance
22 packages offered by the corporation, the Commission found that the package also satisfied

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1 § 113.1(g)(6)(iii)(C). Accordingly, the Commission determined that the proposed severance
2 package would not constitute a prohibited corporate contribution.

3 Information obtained from the responses as well as public documents appear to rebut
4 many of the complaint's contentions and tend to show that McGavick's compensation from the
5 ETSA are not contributions under 11 C.F.R. § 113.1(g)(6)(iii). First, the record appears to
6 support a finding that McGavick's payments from the ETSA were tied exclusively to services
7 provided by him as part of his bona fide employment. 11 C.F.R. § 113.1(g)(6)(iii)(A) and (B).
8 Respondents have provided information, including a sworn affidavit,¹⁴ that Safeco has a past
9 business practice of offering severance packages to other departing executives. For example,
10 Safeco offered a package to Christine Mead, CFO and President of Service, Technology and
11 Finance, who recently departed from Safeco. Respondents also indicate that the ETSA was fully
12 discussed in Safeco's March 27, 2006 Proxy Statement, which it filed with the U.S. Securities
13 and Exchange Commission. The Proxy Statement contains a report by the Compensation
14 Committee on Executive Compensation, which annually reviews the CEO's compensation and
15 ultimately concludes that McGavick's compensation and the ETSA are reasonable.¹⁵ The report
16 states that the ETSA followed the principles of the Compensation Committee, which are: 1) pay
17 for performance; 2) pay competitively; 3) link compensation to shareholder interests; and 4)
18 maintain a rational incentive program.¹⁶ One of these principles, job performance, was one of
19 the factors used by the corporation in AO 2004-08 that the Commission found was sufficiently
20 objective for determining whether to grant a severance package. This principle along with the

¹⁴ See Attachment C at ¶ 5.

¹⁵ Attachment B at 25, 31.

¹⁶ Attachment B at 25-27; Attachment C, Affidavit of Mysliwy at ¶ 6.

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1 other principles used by the Compensation Committee suggest that Safeco bases the granting of
2 severance packages upon relatively objective considerations.

3 With respect to the third criterion, the ETSA compensation offered to McGavick must not
4 exceed what other similarly qualified persons would have received for the same work. *See* 11
5 C.F.R. § 113.1(g)(6)(iii)(C). Respondents suggest that McGavick's employment was most
6 comparable to Christine Mead's. Like McGavick's agreement, Mead's agreement provided for
7 an acceleration of a substantial number of option shares, worth millions of dollars. In addition,
8 Mead was eligible for a 2005 bonus and agreed to a two-year period of noncompetition with
9 Safeco.¹⁷

10 The respondents do not provide information, and there is no information otherwise
11 available, as to whether or not Safeco has a history or practice of allowing departing executives
12 to remain on the payroll to accomplish winding down and transition services even after a
13 successor has commenced employment.¹⁸ Nevertheless, the respondents did provide information
14 suggesting that Safeco took steps to ensure that McGavick's compensation did not exceed what
15 similarly qualified executives would have received for the same work. Specifically, Safeco's
16 Compensation Committee retained two separate outside consultants who reviewed the ETSA to
17 ensure that McGavick's compensation was comparable to its competitors.¹⁹ Further, the

¹⁷ Although McGavick's severance agreement appears to be similar to Mead's package in many respects, Mead was able to depart Safeco approximately 6 months prior to a successor commencing employment with Safeco. McGavick, on the other hand, stayed on the payroll for an additional two months after his successor began her employment, and this extension of his employment enabled him to obtain rights to stock options allegedly worth over \$11 million and to participate in the Cash Balance Plan.

¹⁸ The responses would have also been more complete had the respondents affirmatively asserted what winding down and transition services McGavick provided to the company through February 28, 2006; however, the complaint makes no allegation that McGavick failed to provide these services, and we have no information suggesting that that was the case.

¹⁹ *See id.*

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1 respondents maintain that competitive pay was a key principle in determining executive
2 compensation, and the Compensation Committee specifically found that Safeco's equity (stock)
3 compensation was positioned between the 50th and 70th percentile among 24 peer companies
4 identified in the 2006 Proxy Report.²⁰

5 On balance, while the responses are not factually complete, the allegations in the
6 complaint lack sufficient facts to warrant an investigation. The entire factual basis of the
7 complaint appears to be that Safeco deviated or altered its employment agreement with
8 McGavick after he announced his candidacy and that the new agreement provided him with
9 lucrative benefits that, but for this agreement, he would not have otherwise been entitled to.
10 While this may be true, the complaint appears to describe nothing more than a generous
11 severance package that is not uncommon for departing high-level executives at large companies
12 in that it provides no information tending to show that McGavick did not do *bona fide* work, that
13 he was not paid exclusively for his services to the corporation, or that he was paid more than
14 what similarly qualified executives would have received for the same work. Accordingly, this
15 Office recommends that the Commission find no reason to believe that the respondents violated
16 the Act.

17 **IV. RECOMMENDATIONS**

1. Find no reason to believe that Friends for Mike McGavick, Robert A. Ratliffe, in his official capacity as Treasurer, and Michael McGavick violated 2 U.S.C. §§ 439a, 441b by accepting prohibited contributions and converted such contributions for personal use;
2. Find no reason to believe that Safeco Corporation violated 2 U.S.C. § 441b by making prohibited contributions;
3. Approve the appropriate letters; and

²⁰ See *id* at 26.

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4. Close the file.


Lawrence H. Norton
General Counsel

Lawrence L. Calvert, Jr.
Associate General Counsel
For Enforcement

Date 11/22/06

By:


Ann Marie Terzaken
Assistant General Counsel


Jim Lee
Attorney *Att*

Attachments

- A. Executive Transition Services Agreement
- B. Safeco Corporation 2006 Proxy Statement
- C. Affidavit of Allie Mysliwy